SHAREHOLDERS MUST USE THEIR POWER TO CREATE A NEW ERA OF CORPORATE RESPONSIBILITY

Remarks by State Treasurer Phil Angelides
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Today I want to talk to you about the wave of corporate scandal that has swept through our country, and how we must respond to restore integrity and stability to our financial markets.

I hope to outline a thoughtful approach that will help rebuild confidence in our financial institutions that have been so heavily pummeled by revelations of corporate malfeasance, deception, and fraud.

I suspect that we would have to go back to the days of the Robber Barons of a century ago, or perhaps to the dark days following the stock market crash of 1929, to find an equivalent period in our history.

Mark Twain said, “History does not repeat itself, but it rhymes.” And although the schemes and scams that have come to light during this new millennium differ in detail from those at the beginning of the 20th Century and those that contributed to the crash of ’29, the results are similar. Insiders were profiting while small investors were losing their shirts, corporate officers were drawing huge salaries while their firms were going bankrupt, and overleveraged companies were cooking the books to mislead unwary shareholders. In that sense, recent events “rhyme” with those of the past.

As this astonishing string of corporate improprieties was exposed during the last year-and-a-half, I was led to the inevitable conclusion that the problems go far beyond a few bad apples. They are pervasive. All too many corporate officers and directors, financial consultants, accounting firms and investment banks have been swept up in scandal.

The longer I look at what has transpired, the more I am convinced that this country has a fundamental problem that we have an obligation to address. And the problem starts with the notion that riches can be created quickly, without the hard work and perseverance that steadily builds true wealth over the long haul. This “get-rich-quick” mentality contributed to an unprecedented breakdown in ethics and standards of conduct that has shaken the very foundations of our financial institutions, damaged our economy and harmed millions of pensioners, families and taxpayers.

The enormity and sheer brazenness of many of these misdeeds has shocked even callused investigators.

The FBI has reported that the loot from every bank robbery in America between 1996 and 2001 totaled $208 million. But in less time than it would take to pull what old-time gangsters called a “heist,” California's teacher and public employee pension funds lost more than $850 million after WorldCom disclosed that it had been cooking the books.

While TYCO CEO Dennis Kozlowski was spending $10 million of company money to purchase two luxury New York apartments without authorization from his board of directors, and an additional $11 million to furnish one of them with such items as a $15,000 dog umbrella stand, a $6,000 gold shower curtain, and a $445 pin cushion, Tyco's investors watched its stock lose $106 billion in value as it tumbled from $60 to $7 a share.

And while Ken Lay of Enron mentioned in a conference call with Wall Street analysts last year that $1.2 billion had vanished from the company's net worth – what he conveniently did not say was that he had cashed out of tens of millions in stock before that call.

Bonnie and Clyde, John Dillinger, and Pretty Boy Floyd must be spinning in their graves.

I believe that restoration of the public's faith in our financial system is critical to our sustained economic well-being. Our willingness to invest in the future is based on the belief that our markets operate with integrity, with openness – sometimes we call it transparency” – and with fairness. But that belief has been severely tested in the past year.

In the past, some of the gravest challenges to our economy have occurred after investors have lost confidence in the credibility and soundness of our financial institutions. A whole generation of Americans who weathered the Crash of 1929 and the Great Depression never again invested in the stock market. And for years, some preferred to put their savings under their mattress after so many bank failures in the early ’30s.

For our free enterprise system to work, Americans must be willing to take prudent, and I emphasize “prudent,” risks in a market that is fair and honest.

Renewing public trust in corporate America and in the nation's financial institutions will require the full commitment of those of us who hold public office and also of private sector leaders in the months and years ahead.

Central to this commitment must be the reestablishment of a federal regulatory and enforcement system to make sure the markets operate in the public interest.

That is why I actively supported Senator Paul Sarbanes’ legislation, the Public Company Accounting Reform and Investor Protection Act of 2002, that was signed into law in July of this year. That Act puts in place a framework of corporate accountability to bolster the faith of investors.

But I have been deeply concerned over the past several months that this Administration and the new leadership of Congress have not shown themselves to be fully committed to pursuing an agenda of corporate reform. I am hopeful – now that the President has finally appointed a new SEC chair to replace the disastrous Harvey Pitt, and under pressure, has reluctantly agreed to fully fund the SEC – that we have seen an end to the Administration's dangerous drifting away from reform. Time will tell.

Yet, even with the most robust federal regulatory system, no reform effort will be complete unless the owners of American corporations – the shareholders – also commit themselves to exercising the power of the purse to bring about a new era of corporate responsibility. This is particularly important at this pivotal moment when the commitment of the White House and the Congressional leadership remains untested and when this issue seems to be receding from the front pages and perhaps from the public consciousness. Without a renewed era of activism by America's shareholders, I fear there could be a very quick relapse into the culture of greed that got us into trouble in the first place.

So now is the moment for a renewed era of vigor and vigilance by America's shareholders, given the new contours of our financial markets. In the 1990s, the public equity markets witnessed remarkable growth and change. Corporations enjoyed unprecedented access to capital. Between 1995 and 1999, there were more than 2,800 stock offerings. By 2002, more than 84 million Americans from all walks of life owned stock. Nineteen years earlier, in 1983, just over 42 million Americans were shareholders. Institutional investors, such as pension funds and mutual funds which represent the investments of millions of America's working men and women, now own a little less than half of the nation's equities.

It is clear that institutional investors - who represent police officers, firefighters, nurses, teachers, construction workers and lots of other hardworking people - must be an important force for constructive change in the ethics and accountability of our financial institutions.

Over 200 years ago, an Irish patriot named John Philpot Curran said, "Eternal vigilance is the price of liberty." I would paraphrase that aphorism for the shareholders of today, by saying: "Eternal vigilance is the price of a sound economy." The events of the past year make it incumbent upon investors to make sure that new standards of ethical conduct are securely woven into the fabric of the nation's business practices. So I repeat: The age of shareholder complacency must be replaced by a new age of shareholder democracy.

That is why my office recently released a report – *The Power of the Purse: How Investors Can Restore Integrity to Our Financial Markets* – that is a call to action for investors across the nation, urging them to take the lead in ensuring that corporate reform becomes a reality in this country. And I am traveling throughout my State and across this nation to make this case.

In *The Power of the Purse*, we present six basic tenets that should be at the center of an emboldened shareholder movement.

First of all, investors must demand the highest standards of ethical conduct and transparency – and mean it. They must embrace the commonsense practice of transacting business only with companies known for their honest dealings. That is why, in July, I joined my colleagues from North Carolina and New York in telling investment banks and money managers that they must meet new standard of disclosure and clean up their conflicts or risk losing the right to do business with our states. Consequences for poor corporate behavior will lead to reforms.

A second important principle is that investors should start acting like the owners they are. Shareholders have the power of the vote, and new federal law and stock exchange rules have expanded investor rights. And, although those rights still need further strengthening, investors – under current rules – can dump an incompetent, self-serving, or corrupt board of directors, or reject a stock option plan that serves only the interests of corporate executives. But to do so, they must be willing to do the work that democracy requires, namely, to organize effectively to translate votes into real corporate reform.

We have already started to mobilize investors in the cause of corporate democracy. In August, I co-convened a gathering of public financial leaders from 14 states responsible for the investment of more than $1 trillion in assets, to develop an agenda for common action. And we have begun to work with other investors to launch shareholder resolutions – like the one at GE – that says it is time to peg executive pay to performance.

Which brings me to my third reform principle, which is that investors must actively support corporate policies which reward value, not greed. Shareholders should be willing and prepared to reward performance, innovation, and the creation of long-term value. But providing incentive-based compensation to corporate executives is different than sanctioning a culture of greed.

According to *Business Week*, the average CEO of a major corporation made 42 times the average hourly worker's pay in 1980, 85 times the average worker's pay in 1990, and a staggering 531 times the average hourly worker's pay in 2000. This is wrong. It is time for investors to say, loudly and clearly – enough is enough!

Principle number four: Pension funds and institutional investors need to rethink the passive investment strategies which they have employed for years. Many institutions, in effect, replicate the stock indexes to diversify their risk. But it is now clear that some companies are dealing from a stacked deck. Institutional funds need to embrace more active management of their portfolios and must be willing to shun investments in companies resistant to reform.

Number five, shareholders need to send a clear message: company conduct counts. Too often, institutional investors have tried to construct a wall between their investment decisions and corporate responsibility. Company executives who relocate offshore to avoid taxes or bend environmental laws or exploit their workforce would not think twice about enriching themselves while sticking it to their shareholders. The California Treasurer's Office already is setting an example by prohibiting business dealings with publicly-held expatriate U.S. corporations that relocate offshore – in name only – to dodge taxes and escape legal protections for investors.

And we are sponsoring shareholder resolutions at Tyco, at Ingersoll-Rand and McDermott, telling them that we want them to stop this odious practice and come back home.

Finally, we need to help good companies do the right thing. We must encourage people of proven integrity to serve on corporate boards, and compensate them appropriately. We should reward executives and workers for sustained performance. Most importantly, investors should stop demanding short-term results at the expense of all else. Quarter-by-quarter expectations need to be replaced by shareholder and management commitment to the creation of value over the long term.

In the wake of the market bubble and the excesses we have witnessed, we need to move away from the notions that became popular in the nineties which held that riches can be created through artifice, that the economy can sustain itself in the context of ever-growing disparities of opportunity, and that ethics and corporate responsibility are somehow irrelevant in this new economic age. It is time for all of us to return to the economic values that made this country great – a willingness to make investments for the long term, and a commitment to create true wealth which strengthens our economy and society.

As California's chief investment officer, and as a trustee of nearly $280 billion in State pension and taxpayer funds, my most sacred duties are safeguarding the public treasury; protecting pensioners, families and taxpayers; and restoring the faith and confidence of investors.

That is why I have taken an active role in advancing corporate reform – using the power of California's considerable investment portfolio and market presence to combat corporate fraud and abuse and to set new standards of integrity and corporate responsibility.

As Treasurer of California, I sit on boards of the California Public Employees' Retirement System and the California State Teachers' Retirement System - the first and third largest public pension funds, respectively, in the country, with over $230 billion in assets. I am also responsible for managing the Pooled Money Investment Account with approximately $48 billion in taxpayers' funds, and for overseeing State bond and debt issuances that are expected to exceed $25 billion this year.

This financial presence makes the California State Treasurer's Office a key participant in the marketplace with a unique opportunity and obligation to influence business practices and corporate governance.

As Treasurer, I cannot prosecute company executives who break the law. But I can, as an investor, make it clear that I will not tolerate corporate malfeasance and that California will not countenance those who violate the ethical standards that are the basis of an economy of enduring strength. I call on investors, large and small alike, from across the country, to join in a new era of shareholder activism.

All of us must be prepared to do our part to rid our markets of a culture of dishonesty and greed, and to restore an open, fair, and free economy that has always been part of our national heritage. In so doing, we can renew the faith of investors and sustain America's economic success into the 21st Century.

Thank you.